Last week's fiscal cliff bill perpetuates problems while hardly innovating

David Perry   January 10, 2013

Last week's last-minute fiscal cliff law adds only a little innovation to the 112th Congress' meager record on energy. The American Taxpayer Relief Act of 2012 extends existing tax provisions in support of renewable energy, like the production tax credit for wind, that were set to expire at the end of 2012; it also reinstates retroactively a number of provisions that had expired at the end of 2011.

There are really only two sorts of innovation on energy tax incentives in the bill: First, there are a few new tax credits—for 2- or 3-wheeled alternative fuel vehicles, and for biofuels based on sources like algae. Second, more expansively and expensively, the scope of the various alternative-energy production tax credits (including the wind-energy production tax credit) has been expanded to include projects merely under construction by the end of 2013, and not already "placed in service" as under previous law.

But mostly, the roster of provisions includes extensions of tax credits for alternative fuel vehicles, alternative fuels including cellulosic biofuels and biodiesel, energy efficient homes and appliances, coal from reserves owned by or held in trust for an Indian tribe, and wind energy production, as well as enhanced expensing and depreciation allowances for some property concerned with energy production.

This inability, or political refusal, to innovate, has consequences. Tax "extenders" often turn up in legislation for some obvious reasons: There is no new language to argue over; the language presumably had the intended effects the first time; taxpayers and accountants are familiar with the structure of the incentives; tax return software need be only minimally revised; and all the enacting statute must do is change a date, so no one can sneak any controversial new language in under the radar.

Rejuvenating these expired or expiring measures means Congress is not responding to changing circumstances. As the American Council for an Energy-Efficient Economy (ACEEE) has pointed out, the credits are tailored to specific industries and technologies, giving them a leg up against innovative new technologies or approaches that are not yet covered by the tax code. This conservatism has a price, locking in the tax-favored status of large, politically powerful manufacturers, who lobby Congress for the extenders. The production tax credit for wind energy is a good example. For wind-turbine owners who produce the energy, the production tax credit is a sine qua non for profitability; because Siemens and General Electric sell the equipment to these producers, they support the credit as keeping their line of business open. Therefore, the existence and level of the credit are not based solely on environmental and energy-security concerns, but also on subjective (and fickle) lobbying.

Tax extenders also continue genuine inequities and problems. In ATRA 2012, a good example is probably the extension of the last of the energy-efficient-appliance tax credit under section 45M of the tax code, a credit that is available to appliance manufacturers. Bloomberg and its publication Businessweek have been reporting for years on how Whirlpool has paid no taxes in recent years, thanks in part to the credit. Any beneficial effects of the credit are channeled through the profits of an oligopolic manufacturer, and it's not clear what benefit buyers see from it, or if they would have been interested in energy-efficient appliances regardless of these credits.

Real problems of inequity seem to arise with credits that go to homeowners and small businesses. Implicated here is Congress's extension of the household-level energy-efficient existing-home credit under section 25C . The home-building industry has reported significant progress on installations of energy-efficient equipment and insulation into homes, and lobbied Congress to expand the incentives. However, shoehorning private households' energy-independence and environmental conservation efforts into the Internal Revenue Code with the home energy efficiency credits poses serious equity and administrative problems.

Equity first: a recent study for the Congressional Research Service finds that these credits benefit the wealthier. Because the credits are not refundable—they can generally only be used to offset tax actually owed by individuals in the year in which the energy-efficient property was purchased—people with lower incomes, who may not owe taxes or who are taxed at lower rates, are not incentivized to update their homes. The numbers bear this out, showing that benefit from the credits is heavily skewed towards higher-income individuals.

Administrative problems second: the issue here is the possibly high proportion of waste in government expense. Because the incentives are structured as tax credits, administration and enforcement are left up to the IRS, an agency that already must deal with hundreds of provisions and has only limited mechanisms to audit and otherwise test the application of the credits. Form 5695 does not ask for proof of the home in question (and a glance will show that it's unappealingly complicated and lengthy). Although there is comparatively little revenue impact (certainly less than a hundred million dollars, small compared especially to the levels of medicare fraud in this country), the CRS cites a recent report from an Inspector General at the Treasury Department who found indications that fraud was a strong possibility: 30% of credit applicants could not be confirmed to be homeowners, and at least 5% of those who claimed the credit gave no indication of home ownership at all.

These extenders don't change the energy picture very much; they also don't fix in the minds of the voters or of people in industry that Congress is interested in taking big steps to address America's energy usage. ATRA 2012 is only really newsworthy for one incentive that Congress neglected to reinstitute: the section 1603 grant program. The grants-in-lieu-of-credits were available to taxpayers that might have been eligible for the production tax credit or the investment tax credit expired for projects that were not under construction by the end of 2011 (although another $15.9 billion is expected to be paid out as facilities are placed in service through 2015). Congressional investigations and anger over noisy and expensive government-funded failures ensured that no extension would be passed; this may be just as well for soothing public indignation, but it doesn't speak much for new paths for America's energy future.

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